



BEFORE THE STATE BOARD OF EQUALIZATION  
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of  
SUN VALLEY NATIONAL BANK OF }  
LOS ANGELES }

Appearances:

For Appellant: Frank Fishkin, Attorney at Law

For Respondent: Burl D. Lack, Chief Counsel

O P I N I O N

This appeal is made pursuant to section 26077 of the Revenue and Taxation Code from the action of the Franchise Tax Board in denying the claims of Sun Valley National Bank of Los Angeles for refund of franchise tax in the amounts of \$1,743.58, \$4,057.65, \$6,673.87 and \$3,693.20 for the income years 1954, 1955, 1956 and 1957, respectively. The original claim of \$4,500 for the income year 1957 has been reduced to \$3,693.20 because a refund of \$806.80 was made.

Beginning in 1954, and continuing until his acts were discovered in 1958, appellant's vice president-cashier cashed checks drawn on appellant by depositors who had insufficient funds in their accounts. The accumulated amount of such overdrafts was in excess of \$900,000 and involved an estimated 22 depositors. Later recoveries reduced the losses to approximately \$694,000. The losses were further reduced by a \$225,000 recovery on the employee's bond.

In 1959, appellant filed refund claims with respondent seeking, for each of the income years 1954 through 1957, "an additional Addition to Reserve for Bad Debts equal in amount to the uncollectible overdrafts ..." of two depositors: a small neighborhood garage, and a small neighborhood store. The vice president-cashier's son was employed by the garage. These overdrafts were as follows:

Appeal of Sun Valley National Bank of Los Angeles

<u>Year</u>	<u>Amount</u>
1954	\$ 11,388.96
1955	94,368.11
1956	143,540.17
1957	<u>118,239.22</u>
	\$367,536.46

Both parties assert that a debtor-creditor relationship was created between the depositors and the bank when the overdrafts were cashed. If this relationship was thereby created, the deductibility of the losses is governed by the language and interpretation of the specific code provision relating to bad debt losses. (Spring City Foundry Co. v. Commissioner, 292 U.S. 182 [78 L. Ed. 1200]; Putnam v. Commissioner, 352 U.S. 82 [1 L. Ed. 2d 144].)

Section 24348 (formerly 241211) of the Revenue and Taxation Code provides, in part, that there shall be allowed as a deduction, debts which become worthless within the income year; or, in the discretion of the Franchise Tax Board, a reasonable addition to a reserve for bad debts.

Having elected to use the reserve method of accounting for bad debts, appellant is bound by the well established rule that retroactive additions to a bad debt reserve are not allowable. (Farmville Oil & Fertilizer Co. v. Commissioner, 78 F.2d 83; Rogan v. Commercial Discount Co., 149 F.2d 585; Rio Grande Building and Loan Association, 36 T.C. 657; Colorado County Federal Savings and Loan Association, 36 T.C. 1167, aff'd 309 F.2d 751.) If the reserve proves inadequate, it is to be adjusted currently, not by additions for prior years. (Cal. Admin. Code, tit. 1.8, reg. 24121f(4).)

Appellant asserts that the two depositors were at all times in such financial condition that the checks could never have been made good, that the vice president-cashier was without authority to approve overdrafts and that he concealed his actions in doing so. Appellant, however, has not cited any authority to establish that these facts would permit: an exception to the rule preventing retroactive additions to a reserve for bad debts, nor have we discovered any such authority in our own research,

If appellant's version of the facts were accepted, then it would be necessary to conclude that the acts of its vice president-cashier, done without authority, did not result in debts at all. (Bank of Wyoming 22 B.T.A. 1132; Hendrick Ranch Royalties, T.C. Memo., Dkt. No. 104008, March 22, 1933; People v. Colton, 92 Cal. App. 2d 704 [207 P.2d 890].) Rather, the clandestine misappropriation of

Appeal of Sun Valley National Rank of Los Angeles

'funds described by appellant would clearly constitute embezzlement, regardless of whether the bank officer received direct personal benefit; (Pen., Code, §§ 504, 506; People v. Carson, supra, 92 Cal. App. 2d 704 [207 P.2d 890]; People v. Pierce, 110 Cal. App. 2d 598 [243 P.2d 585]; People v. Holtzendorff, 177 Cal. App. 2d 788 [2 Cal. Rptr. 676].)

Pursuant to section 24347 of the Revenue and Taxation Code, any losses from embezzlement which occurred in the income years after 1954 could be deducted only in the year of discovery of the embezzlement. Although for the year 1954 the statute did not require that embezzlement losses be deducted in the year of discovery (see former section 24121d), the overdrafts for that year were more than covered by the employee's bond. Thus, the overdrafts were not uncompensated losses in that year. (Commissioner v. Harwick, 184 F.2d 835; Allied Furriers Corp., 24 B.T.A. 457.)

We conclude, accordingly, that none of the losses are deductible for the years to which appellant attributes them, whether or not they are regarded as bad debt losses. This result is not only compelled by law, but is far more reasonable than assigning concealed losses to years preceding their discovery. The course which appellant wishes us to pursue could in other cases result in a bar by the statute of limitations and in every case would impose the problem of reconstructing the facts for past years. For the foregoing reasons we must sustain the action of respondent in denying appellant's claims for refund,

O R D E R .

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

Appeal of Sun Valley National Bank of Los Angeles

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 26077 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claims of Sun Valley National Bank of Los Angeles for refund of franchise tax in the amounts of \$1,743.58, \$4,057.65, \$6,673.87 and \$3,693.20 for the income years 1954, 1955, 1956 and 1957, respectively, be and the same is hereby sustained.

Done at Pasadena, California, this 12th day of January, 1965, by the State Board of Equalization.

John W. Lynch, Chairman  
Paul R. Levine, Member  
Pauline H. H. H., Member  
\_\_\_\_\_, Member  
\_\_\_\_\_, Member

Attest

W. H. H.

Secretary